

**THE NASDAQ OPTIONS MARKET LLC  
NOTICE OF ACCEPTANCE OF AWC**

**Certified, Return Receipt Requested**

**TO: Merrill Lynch, Pierce, Fenner & Smith Incorporated  
Mr. J. David Montague  
Associate General Counsel & Senior Vice President  
One Bryant Park  
New York, NY 10036**

**Merrill Lynch Professional Clearing Corp.  
Mr. Gary E. Yetman  
Managing Director  
One Bryant Park  
6<sup>th</sup> Floor  
New York, NY 10036**

**FROM: The NASDAQ Options Market LLC ("Nasdaq")  
c/o Financial Industry Regulatory Authority ("FINRA")  
Department of Market Regulation  
9509 Key West Avenue  
Rockville, MD 20850**

**DATE: June 23, 2015**

**RE: Notice of Acceptance of Letter of Acceptance, Waiver and Consent No. 20110277299-04**

**Please be advised** that your above-referenced Letter of Acceptance, Waiver and Consent ("AWC") has been accepted on **June 23, 2015** by the Nasdaq Review Council's Review Subcommittee, or by the Office of Disciplinary Affairs on behalf of the Nasdaq Review Council, pursuant to Nasdaq Rule 9216. A copy of the AWC is enclosed herewith.

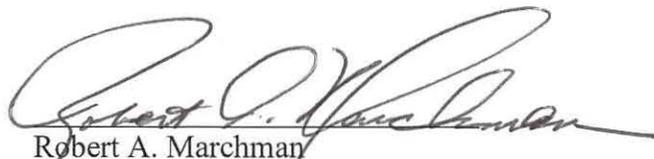
You are again reminded of your obligation, if currently registered, immediately to update your Uniform Application for Broker-Dealer Registration ("Form BD") to reflect the conclusion of this disciplinary action. Additionally, you must also notify FINRA (or Nasdaq if you are not a member of FINRA) in writing of any change of address or other changes required to be made to your Form BD.

You are reminded that Section I of the attached Letter of Acceptance, Waiver, and Consent includes an undertaking. In accordance with the terms of the AWC, a registered principal of the firm is required to notify the Compliance Assistant, Legal Section, Market Regulation Department, 9509 Key West Avenue, Rockville, MD 20850, of completion of the undertaking.

You will be notified by the Registration and Disclosure Department regarding sanctions, and Nasdaq's Finance Department will send you an invoice regarding the payment of any fine.

Merrill Lynch, Pierce, Fenner & Smith Incorporated and  
Merrill Lynch Professional Clearing Corp.  
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If you have any questions concerning this matter, please call W. Kwame Anthony, Senior Counsel,  
at (646) 430-7030.



Robert A. Marchman  
Executive Vice President, Legal Section  
Department of Market Regulation, FINRA

Signed on behalf of Nasdaq

Enclosure

FINRA District 10 – New York  
Michael Solomon, Regional Director  
One World Financial Center  
200 Liberty Street  
New York, NY 10281

Elizabeth H. Baird, Esq.  
Morgan, Lewis & Bockius LLP  
2020 K Street NW  
Washington, DC 20006-1806  
Counsel for Respondent

**THE NASDAQ OPTIONS MARKET LLC**  
**LETTER OF ACCEPTANCE, WAIVER AND CONSENT**  
**NO. 20110277299-04**

TO: The NASDAQ Options Market LLC  
c/o Department of Market Regulation  
Financial Industry Regulatory Authority ("FINRA")

RE: Merrill Lynch, Pierce, Fenner & Smith Incorporated, Respondent  
Broker-Dealer  
CRD No. 7691

Merrill Lynch Professional Clearing Corp., Respondent  
Broker-Dealer  
CRD No. 16139

Pursuant to Rule 9216 of the NASDAQ Stock Market LLC ("Nasdaq")<sup>1</sup> Code of Procedure, Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Pierce") and Merrill Lynch Professional Clearing Corp. ("Merrill Pro") (collectively, the "Firms") submit this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, Nasdaq will not bring any future actions against the Firms alleging violations based on the same factual findings described herein.

**I.**

**ACCEPTANCE AND CONSENT**

- A. Merrill Pierce and Merrill Pro hereby accept and consent, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of Nasdaq, or to which Nasdaq is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by Nasdaq:

**BACKGROUND**

Merrill Pierce has been a FINRA member since 1937, and Merrill Pro has been a FINRA Member since 1985. Both Firms were approved for The Nasdaq Options Market LLC ("NOM") membership on March 12, 2008, and their registrations remain in effect.

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<sup>1</sup> All NASDAQ Options Market LLC disciplinary matters are governed by The Nasdaq Code of Procedure.

## RELEVANT DISCIPLINARY HISTORY

Neither Firm has a relevant prior disciplinary history.

### SUMMARY

1. On behalf of NOM, FINRA staff members (the “staff”) conducted a review of Merrill Pierce’s and Merrill Pro’s order entry activities during the period between 2008 and 2014 (the “review period”) for compliance with Exchange rules, including Chapter III, Sections 1 and 2, Chapter V, Sections 1 and 7, and Chapter IX, Section 1 of NOM Rules, and Section 17(a) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and Rule 17a-3 thereunder.
2. Applicable Exchange rules require that, when accepting an order, a member must obtain and record an appropriate account type or origin code in each order record and as an order detail when entering orders into the Exchange’s systems to indicate the kind of account for which the order will be executed and cleared. Each options market has its own origin codes, but at a minimum, all have codes to indicate that an order is being executed for a customer, a firm, or a market maker. Similarly, when transactions clear at The Options Clearing Corporation (“OCC”), they clear in the “Customer,” “Firm,” or “Market Maker” range (i.e., in the clearing member’s customer account, firm account, or market maker account at OCC). Origin codes are important because, among other things, they affect the accuracy of the firm’s order records and the Exchange’s audit trail. In addition, origin codes must be accurate as part of ensuring that trades are reported to OCC with accurate trade details.
3. During the review period, Merrill Pierce and Merrill Pro violated certain NOM rules and federal securities laws when entering and executing certain orders on behalf of their broker-dealer clients. The Firms improperly marked numerous options orders with incorrect origin codes and sent those orders to the Exchange through various order entry systems employed by the Firms to send options orders, resulting in: (i) an inaccurate audit trail and inaccurate order records; (ii) trades being reported to OCC with inaccurate trade details; and (iii) an adverse impact to the Exchange’s ability to surveil for and detect potential violations of its rules and of federal securities laws. Additionally, the staff concluded that the Firms had supervisory deficiencies related to these matters, which are outlined in detail herein.

## FACTS AND VIOLATIVE CONDUCT

### Inaccurate Origin Codes

4. Pursuant to Chapter V, Section 7 of NOM Rules, an Options Participant must submit specific information prescribed by Nasdaq when submitting orders on NOM and must record information prescribed by Nasdaq on an order record for each customer order.
5. During the review period, Merrill Pierce executed numerous transactions with incorrect origin codes across multiple markets, including NOM. Merrill Pierce's execution of orders with incorrect origin codes resulted from certain accounts having been on-boarded<sup>2</sup> with incorrect origin codes in their respective account profiles (e.g., an account that should have been coded as "Firm" was coded as "Customer," and some orders entered for that account were entered incorrectly with the "Customer" origin code), limitations in its order management system that failed to include all potential origin code designations or defaulted to an improper origin code at various points during the review period, and from errors made by Merrill Pierce employees when placing origin codes on orders at the point of order acceptance, entry, or execution.
6. From 2008 until July 2011, when Merrill Pro ceased accepting orders for execution, Merrill Pro executed numerous transactions with incorrect origin codes across multiple markets, including the Exchange. Merrill Pro used incorrect account origin codes to execute trades for certain accounts because it had placed the wrong origin code in the account profiles of those accounts at on-boarding.
7. Despite the fact that in each year from 2008 through 2010, the Firms traded millions of contracts by executing orders with incorrect origin codes, they lacked procedures for ensuring orders had been entered with correct origin codes, and for conducting reviews to detect that orders had been entered and executed with incorrect origin codes. Instead, the Firms only learned about misrepresented orders in isolation—for example, when reconciling positions on their books with positions at OCC on the day after a trade, when a client complained that an order had been executed with an incorrect origin code, or when an exercise had taken place incorrectly—and then addressed each instance in isolation and on an ad hoc basis.
8. In approximately 2007, an employee in Merrill Pro's Chicago office, who handled clearing for both Firms' clients, began gathering data to respond to an increasing number of regulatory inquiries where FINRA was investigating different Merrill Pro customers' use of incorrect origin codes. In 2010, this employee grew concerned that in instances when Merrill Pierce's traders had executed trades and requested origin code changes, making origin code changes at the exchanges and making post-trade adjustments at OCC could evidence regulatory violations or bring regulatory scrutiny. Despite this knowledge, neither Firm had taken measures to ensure that it executed

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<sup>2</sup> "On-boarding" refers to the process of setting up a client's account in Merrill Pierce's or Merrill Pro's order management system.

orders with correct origin codes, or to detect instances in which it had executed orders with incorrect origin codes.

9. Although Merrill Pierce began taking steps later in 2010 to address the execution of orders with incorrect origin codes, after conducting a review that led to the creation and implementation of exception reports to identify instances in which it had executed orders with incorrect origin codes, it still continued trading hundreds of thousands of contracts each year with incorrect origin codes through 2014.
10. Merrill Pro never addressed its ongoing deficiencies relating to its inaccurate use of origin codes before it stopped transmitting and executing orders altogether in July 2011.
11. Each instance in which Merrill Pierce or Merrill Pro executed an order with an incorrect origin code could have had adverse consequences, such as creating inaccurate order records, creating an inaccurate audit trail, reporting trades to OCC with inaccurate trade details, and adversely impacting NOM's ability to surveil for and detect potential violations of its rules and federal securities laws.
12. By marking orders with the wrong origin code, Merrill Pro and Merrill Pierce violated the following rules:
  - a. Section 17(a)(1) of the Securities Exchange Act of 1934 and SEC Rule 17a-3(a)(6)(i) thereunder requiring Options Participants to create a memorandum of each order, and any other instruction, showing the terms and conditions of the order.
  - b. Chapter III, Section 1, which prohibits an Options Participant from violating the Exchange Act or rules thereunder, NOM rules, or OCC rules as they relate to reporting or clearing any NOM transaction.
  - c. Chapter III, Section 2, which requires an Options Participant to ensure transactions comply with the Participant's obligations under NOM and OCC rules and any other relevant laws or rules.
  - d. Chapter V, Section 7(a), which requires an Option Participant entering orders on NOM to submit orders in a form as prescribed by Nasdaq to allow NOM to properly prioritize and match orders and report resulting transactions to OCC.
  - e. Chapter V, Section 7(b), which requires an Options Participant to record each options order received from a Customer for execution on NOM. The order record must contain certain specific information and other information as NOM requires.
  - f. Chapter IX, Section 1, which requires each Options Participant to make and preserve books and records as Nasdaq prescribes pursuant to Exchange rules and as prescribed by the Exchange Act and rules thereunder.

## Supervision

13. NOM Rule Chapter III, Section 1 requires a Member to supervise persons associated with the Member with respect to compliance with the Exchange Act and rules thereunder, NOM rules, and OCC rules as they relate to reporting or clearing NOM transactions. Chapter III, Section 2 requires that an Options Participant have adequate arrangements to ensure that its staff is suitable, adequately trained and properly supervised, be responsible for the acts of its associated persons, and ensure that accurate information is input into NOM's trading system. Chapter V, Section 1(b)(iii) and (iv) prohibit an Options Participant from failing to supervise to ensure compliance with Chapter V, Section 1(b) and failing to maintain adequate procedures and controls to monitor and supervise the entry of orders to prevent practices prohibited by Chapter V, Section 1(b) and Chapter III, Section 2. The Firms failed to have adequate supervisory systems and controls in place, including written supervisory procedures and separate systems of follow-up and review, which were reasonably designed to achieve compliance with the origin code requirements.
14. Prior to October 2010, Merrill Pierce did not have any exception reports to identify incorrect origin codes on orders and had no system whatsoever for conducting reviews to ensure that correct origin codes were placed on orders. Instead, Merrill Pierce often learned it had used incorrect origin codes only when its clients informed it that trades had been executed with an incorrect origin code, or because problems arose when trades had cleared in the wrong range at OCC (e.g., clearing in the "Customer" range when they were supposed to have cleared in the "Firm" range). These instances resulted in discrepancies between Merrill Pierce's positions on its own books and its positions on OCC's books. Merrill Pierce would then make adjustments at OCC to move positions into the proper range. After that time, whenever a certain employee within Merrill Pro became concerned that making origin code adjustments could invite regulatory scrutiny or action, the employee informed others within the organization that adjustments would only be made if certain other employees approved them. Yet, the violations continued. Additionally, despite instituting an exception report and supervisory reviews in 2010, Merrill Pierce continued entering and executing orders with incorrect origin codes through 2014.
15. Merrill Pro never had a system for identifying incorrect origin codes on orders or conducting any reviews to ensure correct origin codes were placed on orders. Instead, as with Merrill Pierce, Merrill Pro learned that trades had been entered with incorrect origin codes as a result of discrepancies between its positions on its own books and its positions with OCC. In addition, through 2014, Merrill Pro never had a system of supervision to ensure that the trades for which it was the clearing firm cleared with the correct origin codes at OCC.
16. In summary, during the review period, the Firms failed to have supervisory systems and controls in place, including a separate system of follow-up and review, reasonably designed to achieve compliance with NOM's origin code requirements in that the Firms failed to do the following: (i) reasonably address origin code

requirements in the development and programming of its order entry systems; (ii) maintain written supervisory procedures reasonably designed to achieve compliance with the Exchange's rules relating to the assignment of origin codes; (iii) adequately train its employees with respect to the significance of properly marking origin codes in its order entry systems; and (iv) adequately supervise its employees with respect to the proper marking of origin codes.

17. The conduct described in Paragraphs 14 through 16 violated NOM Rules Chapter III, Sections 1 and 2 and Chapter V, Section 1(b)(iii) and (iv).

B. Merrill Pierce and Merrill Pro consent to the imposition of the following sanctions:

1. A censure and a joint and several fine in the amount of \$9,000,000, of which \$225,000 shall be paid to NOM.<sup>3</sup>
2. Merrill Pierce agrees to an undertaking pursuant to which at intervals of 90, 180, 270, and 360 days after acceptance of this AWC, Merrill Pierce shall make a written submission to NOM, in care of FINRA, regarding its compliance with NOM's rules and policies governing the inclusion of account origin codes in order and execution data. At a minimum, the written submission shall address and include the following:
  - a. an assessment of the degree to which Merrill Pierce has taken additional remedial steps to confirm that it is including accurate account origin codes in its order records and in electronic entries of order and transaction data in NOM's systems;
  - b. the adequacy of Merrill Pierce's policies, systems, procedures, and training relating to including accurate account origin codes in its order and execution audit trail data;
  - c. copies of all exception reports identifying instances in which inaccurate account origin codes were included in Merrill Pierce's order and execution audit trail data.
  - d. an explanation of all remedial actions that Merrill Pierce had taken in response to instances appearing on the exception reports produced in response to Item B.2.c.
3. Merrill Pro agrees to an undertaking to revise its written supervisory procedures with respect to the areas described in Paragraph I.A.15. Within 30 business days of acceptance of this AWC, a registered principal of Merrill Pro shall submit to the COMPLIANCE ASSISTANT, LEGAL SECTION, MARKET REGULATION DEPARTMENT, 9509 KEY WEST AVENUE, ROCKVILLE, MD 20850, a signed,

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<sup>3</sup> The balance of the fine will be paid to the self-regulatory organizations listed after Paragraph B.3.

dated letter, or an e-mail from a work-related account of the registered principal to MarketRegulationComp@finra.org, providing the following information: (1) a reference to this matter; (2) a representation that Merrill Pro has revised its written supervisory procedures to address the deficiencies described in Paragraph I.A.15; and (3) the date the revised procedures were implemented.

Acceptance of this AWC is conditioned upon acceptance of similar settlement agreements in related matters between Merrill Pierce and Merrill Pro collectively and each of the following self-regulatory organizations: BATS Exchange Inc.; Chicago Board Options Exchange, Incorporated; International Securities Exchange LLC; NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC; and NYSE Regulation, Inc. on behalf of NYSE Arca Inc. and NYSE MKT LLC.

Merrill Pierce and Merrill Pro agree to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. Merrill Pierce and Merrill Pro have submitted an Election of Payment form showing the method by which they propose to pay the fine imposed.

Merrill Pierce and Merrill Pro specifically and voluntarily waive any right to claim that they are unable to pay, now or at any time hereafter, the monetary sanctions imposed in this matter.

The sanctions imposed herein shall be effective on a date set by the staff.

## II.

### WAIVER OF PROCEDURAL RIGHTS

Merrill Pierce and Merrill Pro specifically and voluntarily waive the following rights granted under the Rules of the Exchange and the Exchange Code of Procedure:

- A. to have a Formal Complaint issued specifying the allegations against the Firms in writing;
- B. to be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;
- C. to defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. to appeal any such decision to the Nasdaq Review Council and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Merrill Pierce and Merrill Pro specifically and voluntarily waive any right to claim bias or prejudgment of the Chief Regulatory Officer, the Nasdaq Review Council, or any member of the Nasdaq Review Council, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Merrill Pierce and Merrill Pro further specifically and voluntarily waive any right to claim that a person violated the ex parte prohibitions of Rule 9143 or the separation of functions prohibitions of Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

### **III.**

#### **OTHER MATTERS**

Merrill Pierce and Merrill Pro understand that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by FINRA's Department of Market Regulation and the Nasdaq Review Council, the Review Subcommittee, or the Office of Disciplinary Affairs ("ODA"), pursuant to Nasdaq Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Merrill Pierce and Merrill Pro; and
- C. If accepted:
  1. This AWC will become part of Merrill Pierce's and Merrill Pro's permanent disciplinary records and may be considered in any future actions brought by Nasdaq or any other regulator against the Firms;
  2. Nasdaq may release this AWC or make a public announcement concerning this agreement and the subject matter thereof in accordance with Nasdaq Rule 8310 and IM-8310-3; and
  3. Merrill Pierce and Merrill Pro may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. The Firms may not take any position in any proceeding brought by or on behalf of

Nasdaq, or to which Nasdaq is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Merrill Pierce's or Merrill Pro's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which Nasdaq is not a party.

- D. Merrill Pierce and Merrill Pro may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The Firms understand that they may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by Nasdaq, nor does it reflect the views of Nasdaq or its staff.

The undersigned, on behalf of Merrill Pierce and Merrill Pro, certify that persons duly authorized to act on their behalves have read and understand all of the provisions of this AWC and have been given a full opportunity to ask questions about it; that the Firms have agreed to the AWC's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce Merrill Pierce and Merrill Pro to submit it.

Date

May 11, 2015

Respondent

Merrill Lynch, Pierce, Fenner & Smith Incorporated

By: J. David Montague

Name: J. David Montague

Title: Associate General Counsel + Senior VP

Date

5-11-2015

Respondent

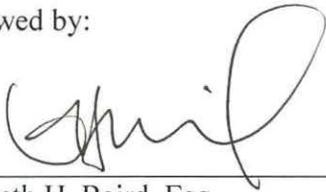
Merrill Lynch Professional Clearing Corp.

By: Gary E. Yetman

Name: Gary E. Yetman  
Managing Director

Title: \_\_\_\_\_

Reviewed by:



Elizabeth H. Baird, Esq.  
Morgan, Lewis & Bockius LLP  
2020 K Street NW  
Washington, DC 20006-1806  
(202) 373-6561  
elizabeth.baird@morganlewis.com

Counsel for Merrill Lynch, Pierce, Fenner & Smith Incorporated  
and Merrill Lynch Professional Clearing Corp.

Accepted by The Nasdaq Options Market LLC:



Date



Robert A. Marchman  
Executive Vice President  
Department of Market Regulation

Signed on behalf of The Nasdaq Options  
Market LLC, by delegated authority from  
the Director of ODA

**ELECTION OF PAYMENT FORM**

Merrill Lynch, Pierce, Fenner & Smith Incorporated and Merrill Lynch Professional Clearing Corp. intend to pay the fine proposed in the attached AWC by the following method (check one):

- A firm check or bank check for the full amount;
- Wire transfer;
- The installment payment plan.<sup>4</sup>
  - Monthly
  - Quarterly

Respectfully submitted,  
Merrill Lynch, Pierce, Fenner & Smith Incorporated

May 11, 2015  
Date

By: J. David Montague  
Name: J. David Montague  
Title: Associate General Counsel / Senior VP

Respectfully submitted,  
Merrill Lynch Professional Clearing Corp.

\_\_\_\_\_  
Date

By: Gary Eget  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

<sup>4</sup> The installment payment plan is only available for a fine of \$50,000 or more. Certain requirements apply.